80-1562

No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MARINE BANK
Petitioner

v.

SAMUEL WEAVER and ALICE WEAVER

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

SAMUEL WEAVER and ALICE WEAVER, *Appellants*

v.

MARINE BANK

(D.C. CIvil NO. 79-0066)

SUR PETITION FOR REHEARING

Present: SEITZ, *Chief Judge,* ALDISERT, ADAMS, GIBBONS, HUNTER, WEIS, GARTH, HIGGINBOTHAM and SLOVITER, *Circuit Judges*

The petition for rehearing filed by

Appellee

in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

Judges Weis and Garth would grant rehearing.

By the Court,

JOHN J. GIBBONS
Judge

January 26, 1981

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

QUESTIONS PRESENTED FOR REVIEW

1. Is an FDIC-insured non-equity certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, a "security" as defined in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5.

2. Unknown to the lending bank, as consideration for acting as guarantors on a business loan, an agreement was signed between the primary obligors and the guarantors giving the guarantors:

(a) the right to use the barn and pasture of the business;

(b) the right to receive 50% of the "adjusted net profits" of the business so long as they remained co-obligors;

(c) the right to receive $100 per month until repayment of the loan; and

(d) the right to veto any future loans to the business; thereby raising the question whether this agreement is a "security" as defined in the Securities Act of 1933, the Securities Act of 1934 and the Securities and Exchange Commission's Rule 10b-5 and, if a security, whether the bank can be held liable.

PARTIES

The caption of the case contains the names of all parties to the proceeding before the United States Court of Appeals for the third Circuit.

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JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was dated December 15, 1980 and entered December 15, 1980. See Appendix D. p. A-43, *infra.*

A petition for rehearing before the original panel and before the court in banc was denied by order dated January 26, 1981, and entered January 26, 1981. See Appendix E, p. A-44, 45, *infra.*

The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

Securities Act of 1933, 15 U.S.C. § 77b(1):

> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10):

> (10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation

in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Securities Act of 1933, 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the

statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

This case is a suit brought by the guarantors of a commercial loan, Samuel and Alice Weaver, against Marine Bank, the lender. The loan was made on March 17, 1978, in the principal amount of $65,000 to Columbus Packing Company, a proprietorship consisting of a wholesale slaughterhouse and retail meat store owned by Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo.

Some time prior to the loan closing on March 17, 1978, Raymond and Barbara Piccirillo and the Weavers had entered into an agreement which provided that as consideration for Weavers acting as co-obligors on the loan, Weavers were given the following rights:

1) to use the barn and pasture on the slaughterhouse premises;

2) to receive 50% of the "adjusted net profits" of Columbus Packing so long as Weavers remained as co-obligors;

3) to receive $100 per month until the loan was repaid; and

4) to veto any future loans to columbus Packing.

The bank was never informed of this agreement or its contents.

On March 17, 1978, the bank loaned Raymond and Barbara Piccirillo, doing business as Columbus Packing, the sum of $65,000. A $65,000 demand note was signed by Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo d/b/a Columbus Packing Company and was co-signed by Raymond A. Piccirillo and Mary T. Piccirillo. Samuel and Alice Weaver executed an agreement of guaranty which guaranteed payment of the principal debtors to a maximum of $50,000. Collateral for the loan included the pledge by Samuel and Alice Weaver of a $50,000 certificate of deposit issued by Marine Bank. This certificate of deposit, bearing a due date of February, 1984, had been previously purchased by the Weavers on February 28, 1978 at the Corry, Pa. branch of Marine Bank, not for the purpose of using it in the Piccirillo transaction, but rather for the purpose

of having money nearby for the operation of their livestock auction which they operated in that area. Columbus Packing filed bankruptcy on July 21, 1978.

The Weavers filed a complaint, the basis for federal jurisdiction being an alleged violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and, in a motion for leave to file an amended complaint, plaintiffs alleged bank conduct violative of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a). This conduct allegedly involved a failure of the bank to disclose to the Weavers prior to the loan closing the financial situation of Columbus Packing. On motion for summary judgment filed by the bank, the district court dismissed the action for lack of jurisdiction, holding that no purchase or sale of a security was involved.

A three-judge panel of the court of appeals, with one judge dissenting, reversed, holding that both the certificate of deposit and the agreement constituted "securities" and that the pledge of the certificate of deposit constituted a "sale". A petition for rehearing was denied by the same three-judge panel, and a petition for rehearing in banc was denied by a majority of the circuit judges with two dissents.

REASONS FOR GRANTING THE WRIT

A. First Question Presented: An FDIC-insured non-equity certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, is not a "security" as defined in the Securities Act of 1933 or the Securities Exchange Act of 1934.

1. *Conflict with Other Decisions*

This case is the first decision of the Third Circuit to hold that an FDIC-insured non-equity certificate of deposit, issued by a commercial bank, is a security under the 1933 Securities Act and 1934 Securities Exchange Act (hereinafter, the 1933 and 1934 Acts). This holding is, as noted in the court of appeals' opinion, in direct conflict with decisions of other federal courts of appeals which conclude that such instruments are not securities. *Canadian Imperial Bank*

of Commerce Trust Co. v. Fingland, 615 F.2d 465, 470 (7th Cir. 1980); *Bellah v. First National Bank of Hereford, Texas,* 495 F.2d 1109, 1114-1116 (5th Cir. 1974); *Burrus, Cootes and Burrus v. MacKethan,* 537 F.2d 1262 (4th Cir. 1976), withdrawn as moot 545 F.2d 1388, 1391 (4th Cir. 1976). The decision also conflicts in substance with *Amfac Mfg. Corp. v. Arizona Mall of Tempe,* 583 F.2d 426 (9th Cir. 1978); *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.,* 508 F.2d 1354 (7th Cir. 1975); *McClure v. First National Bank of Lubbock, Texas,* 497 F.2d 490 (5th Cir. 1974).

The panel itself which decided this case was sharply divided. While the Securities and Exchange Commission has taken the position that certificates of deposit issued by banks are securities, there is nothing in the language of the 1933 and 1934 Acts definitions of a "security" or in the legislative history of those acts to infer that Congress intended bank certificates of deposit to be included as "securities." Rather, an analysis of the 1933 and 1934 Acts as opposed to the Glass-Steagall Banking Act of 1933 discloses two separate and distinct federal schemes of regulation. Both schemes were passed by the 73rd Congress to prevent the recurrence of abuses caused by bank involvement in securities activities which gave impetus to the 1929 stock market crash. The 1933 and 1934 Acts were therefore designed to protect investors in "securities" by assuring that those investors were adequately informed in buying and trading *without* guaranteeing the soundness of their investment; the Glass-Steagall Act was designed to supervise the soundness of banks, to *ensure* deposits against loss through creation of the Federal Deposit Insurance Corporation and to specifically prohibit banks who took deposits from becoming involved in the securities business. This scheme was intended by Congress to sever commercial banking from investment activity.

To treat a certificate of deposit as a security would superimpose on already existing federal and state banking regulatory schemes a second pattern of regulations by the Securities and Exchange Commission, with attendant risks of inter-agency conflict and of the Security and Exchange Commission's want of specialized relevant expertise in this area of banking. *Burrus, Cootes and Burrus, et. al. v. MacKethan,* 537 F.2d at 1265.

In concluding that the certificate of deposit in this case was a "security", the Third Circuit relied upon two premises which are inconsistent with applicable decisions of this Court.

First, the Third Circuit relied almost exclusively upon this Court's decision in *Tcherepnin v. Knight*, 389 U.S. 332 (1967). The application of that case was in error, as the "shares" at issue in *Tcherepnin* were held to be investment in nature because they were withdrawable capital shares, which carried a right to vote and were not entitled to a fixed rate of return since state law tied the payment of dividends to an apportionment of the profits. None of these factors apply to a bank certificate of deposit, which carries no voting rights, pays a fixed rate of interest and does not represent shares in the bank.

The court's misconstruction of *Tcherepnin* was based upon a false impression. The Third Circuit reasoned that when this Court wrote *Tcherepnin* it "must have been aware" that the Administrator of National Banks had in 1966 endorsed the Security and Exchange Commission's view that deposit accounts are securities. In fact, the Administrator had *not* concurred in that position but merely stated it without concurrence.

Secondly, the Third Circuit stated its premise for the opinion as follows: ". . . the federal courts ought to interpret the 1934 Act with a presumption of coverage of any transaction which Congress did not expressly exclude," (Appendix A. p. A-13, *infra*. This premise conflicts with this court's decision in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979) which looked to the economic realities of the transaction to determine whether Congress intended to *include* the particular financial interest, rather than to exclude it. The "economic realities" test of this court, enunciated in *United Housing Foundation, Inc. v. Forman* 421 U.S. 837, 851-852 (1975), was ignored by the court of appeals.

2. Impact on the Banking Industry

The holding of the Third Circuit that a certificate of deposit issued by a commercial bank is a security has wide-spread impact on the banking industry. Section 21 of the Glass-Steagall Act, 12 U.S.C. § 378(a) prohibits investment banking concerns from engaging

in deposit banking activities. Section 16 of that act prohibits banks from underwriting, buying or selling equity securities for their own accounts except under limited exceptions whose parameters would not include a certificate of deposit. The act is designed to divorce commercial banking from investment banking. To eliminate the distinction between equity securities and time deposits, as the Third Circuit has done, places the day to day activities of many commercial banks in accepting time deposits in violation of the Glass-Steagall Act.

The Third Circuit's reasoning that "the 1934 Act defines securities so broadly as to include virtually every transaction in which an investor might expect to receive a return on his money" (Appendix A, p. A12-13, *infra.)* extends federal court jurisdiction to any routine banking transaction in which the bank issues an instrument which constitutes evidence of interest payable because of currency deposited in an account. Such transactions would include interest-bearing commercial checking accounts ("NOW" accounts) and savings accounts. The reach of the securities laws should not be extended into these banking areas intentionally excluded by Congress and treated under a separate and more comprehensive system of supervision under federal and state banking laws, a philosophy adopted by several courts of appeals which have found bank loans evidenced by promissory notes not within the purview of the Securities Acts. *McClure v. First National Bank of Lubbock, Texas,* 497 F.2d 490 (5th Cir. 1974); *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.,* 508 F.2d 1354 (7th Cir. 1975); *Amfac Mtg. Corp. v. Arizona Mall of Tempe,* 583 F.2d 426 (9th cir. 1978).

B. Second Question Presented:

The Piccirillo Agreement is not a "security" as defined in the 1933 and 1934 Securities Acts.

1. *Conflict with Other Decisions*

The decision that the Piccirillo agreement constitutes a "security" is based upon and seriously misapplies the criteria for a security under the 1933 Securities Act as set forth in *SEC v. W. J. Howey Co.,* 328 U.S. 293, 301 (1946) and as extended to the 1934 Securities Exchange Act in *Tcherepnin v. Knight,* 389 U.S. 332 (1967), which test requires a "common enterprise with profits to come solely from

the efforts of others." The Piccirillo agreement gave the Weavers the following rights:

(a) to use the barn and pasture of the Piccirillo business;

(b) to receive 50% of the "adjusted net profits" of the Piccirillo business so long as Weavers remained co-obligors;

(c) to receive $100 per month until repayment of the loan; and

(d) to veto any future loans to the Piccirillo business.

The agreement, signed in the Weaver's trailor, was strictly between Mr. and Mrs. Piccirillo, who operated a slaughterhouse and Mr. and Mrs. Weaver, who ran a cattle auction. *Howey* and numerous courts of appeals cases agree there cannot exist a "common enterprise with profits to come solely from the efforts of others" when a private agreement is reached with a single party rather than multiple investors, which agreement is not publicly offered, not advertised, not offered or sold, not distributed, and involves no pooling of assets. This Court and the courts of appeals indicate that at least one or more of these factors must be present. *Howey, supra, Tcherepnin v. Knight,* 389 U.S. 332 (1967); *Hirk v. Agri-Research Council, Inc.,* 561 F.2d 96 (7th Cir. 1977); *Milnarik v. M-S Commodities, Inc.,* 457 F.2d 274 (7th Cir. 1972), *certiorari denied,* 409 U.S. 887; *Wasnowic v. Chicago Board of Trade,* 352 F. Supp. 1066 (M.D. Pa. 1972), *aff'd. mem.,* 491 F.2d 752 (3rd Cir.), *cert. denied,* 416 U.S. 994 (1974); *SEC v. Continental Commodities Corporation,* 497 F.2d 516 (5th Cir. 1974); *Great Western Bank and Trust Co. v. Kotz,* 532 F.2d 1252 (9th Cir. 1976).

This agreement represents, rather, a private arrangement between two married individuals both engaged in the cattle business - Weaver in selling cattle, Piccirillo in slaughtering them. Weaver obtained the right to pasture and house his cattle on the Piccirillo business property and to veto any future loans to Piccirillos' business. This transaction was individually contracted and tailor-made to suit the needs of both parties. There being no other party to the deal, Weaver pooled his "investment" with no one. This absence of a pooling arrangement, combined with the absence of other factors such as a public offering, advertising or public interest, remove the Piccirillo agreement from the boundaries established by this Court for an investment "security".

The record being undisputed that the bank had no knowledge of the existence of the agreement, the court of appeals erred in not requiring any allegation of scienter or an intent to deceive on the part of the bank in connection with the agreement, in conflict with this Court's decision in *Ernst and Ernst v. Hochfelder*, 425 U.S. 185 (1976). The bank could not have the proper mental state intending to deceive the Weavers in connection with a "security" or scheme which the bank did not know existed. The same reasoning was applied in *Woodward v. Metro Bank of Dallas*, 553 F.2d 84 (5th Cir. 1975), which held a bank cannot be implicated in a 10b-5 violation unless it is aware of the improper activity and its role in furthering that activity. The refusal of the court of appeals to consider the bank's lack of knowledge that the "security" even existed means that any bank lending funds to a debtor involved in market manipulation is exposed to automatic 10b-5 liability. To permit the Third Circuit's decision on the Piccirillo agreement to stand will, therefore, have the immediate effect of making all banks and lending institutions the insurers of their debtors.

CONCLUSION

For these reasons, a Writ of Certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

SAMUEL WEAVER AND ALICE WEAVER,
Appellants

v.

MARINE BANK
(D.C. Civil No. 79-0066)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Argued September 18, 1980
Before: GIBBONS, WEIS and SLOVITER, *Circuit Judges*
(Opinion Filed December 15, 1980)

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OPINION OF THE COURT

GIBBONS, *Circuit Judge.*

Samuel and Alice Weaver appeal from an order granting summary judgment in favor of Marine Bank (Bank) on their complaint seeking equitable relief against or damages from the Bank. The complaint asserts federal question jurisdiction, alleging that the Bank violated section 10(b) of the Securities Exchange Act of 1934 (1934 Act), 48 Stat. 891, 15 U.S.C. § 78j(b).[1] It also pleads pendant claims for violation of the Pennsylvania Securities Act, Pa. Stat. Ann. tit. 70, § 1-101 et. seq. (Purdon Supp. 1980), and for common law fraud. The district court granted summary judgment on the federal law claim and declined to exercise pendent jurisdiction over the state law claims. We reverse.

I.

Facts and Proceedings in the District Court

Many of the facts are undisputed. Marine Bank, beginning sometime in 1976, made three loans to Columbus Packing Company, an unincorporated business owned by Raymond J. and Barbara J. Piccirillo. Columbus Packing operated a wholesale slaughterhouse and a retail meat market in Corry, Pennsylvania. The loans were secured by perfected security interests in equipment, inventory and accounts receivable, liens on several motor vehicles, and second mortgages on two pieces of real estate. Early in 1978 Robert Santom, newly appointed manager of the Corry branch of Marine Bank, designated the Columbus Packing loans as concerned loans because he did not believe the proprietorship had adequate cash flow and because there was no set repayment program. Besides the outstanding loans, Columbus Packing also had a substantial overdraft position with the Bank. Santom told Mr. Piccirillo that the bank would take possession of its collateral and sell it unless Piccirillo either found a buyer, sold his business and paid the bank, closed the business and sold its assets to pay the bank, or secured additional capital.

1. In a motion for leave to file an amended complaint the Weavers also alleged that the Bank's conduct violated § 17(a) of the Securities Act of 1933, 48 Stat. 84. 15 U.S.C. § 77q(a).

On March 17, 1978, a new loan agreement was executed, whereby the Bank loaned Columbus Packing $65,000 on a demand note signed by the Piccirillos, secured as before, by security agreements covering equipment, inventory and accounts receivable, liens on motor vehicles, and liens on the same two pieces of real estate. Simultaneously Mr. and Mrs. Weaver, who were farmers engaged in auctioning livestock, signed an agreement of guaranty which guaranteed payment of the Piccirillos' debt to a maximum of $50,000. To secure this guaranty, the Weavers pledged to the bank a $50,000 certificate of deposit issued by the Marine Bank to them, payable in six years, and bearing interest at six percent. To purchase this certificate of deposit from Marine Bank's Corry branch, the Weavers withdrew $50,000 from another bank. Aged 79 and 71 respectively, they had no formal education beyond the eighth grade, and had spent their lives as cattle farmers.

Prior to the closing on the loan, guaranty, and pledge, the Piccirillos and the Weavers entered into a written agreement providing that the Weavers were to receive fifty percent of the "adjusted net profits" of Columbus Packing and the sum of $100 a month.

The proceeds of the $65,000 loan were forthwith disbursed to repay loans and overdraft obligations to the Bank approximating $42,800, to pay past due federal taxes, and to pay past due obligations to trade creditors. That left approximately $3,800 for working capital. Four months later, Columbus Packing filed a bankruptcy petition. The Bank's security in property of Columbus Packing or of the Piccirillos is inadequate, and it intends to resort, for the deficiency, to the pledged certificate of deposit.

Turning to the disputed facts, the Bank contends that prior to the closing on the loan and guaranty it disclosed to the Weavers all the Columbus Packing debts of which it had knowledge, that at that time it believed its loans were fully collateralized by the Columbus Packing and Piccirillo properties, and that it had no knowledge whatsoever of the agreement between the Piccirillos and the Weavers. From the pleadings, affidavits, and depositions on file, however, a fact finder could find that at a time the Bank was aware of Columbus Packing's desperate financial condition, and doubtful about the

adequacy of its collateral position, employees of the Bank approached the Weavers and urged them to make an investment in Columbus Packing for the purpose of providing working capital. The Weavers then had no knowledge of or interest in investing in a slaughterhouse business. Further, it could be found that the Weavers initially declined Marine Bank's suggestion that they make such an investment, but were persuaded to pledge their certificate of deposit in exchange for a $65,000 loan to Columbus Packing on the representation that substantially all of the loan would be available to that business for working capital, and on the representation that the existing collateral adequately protected both their interest and the Bank's.

The district court did not conclude that the conduct of the Bank's agents which a fact finder might find, if it occurred "in connection with" the sale or purchase of a security, would not be a violation of section 10(b)(5). The court appears to have assumed, without deciding, that liability might be predicated upon a conclusion that as an insider, having access to information not available to the public, the Bank had a duty to disclose material adverse information, or that even if the Bank were not treated as an insider it might be found to be an aider and abettor in a fraud committed by the Piccirillos. *See, e.g., SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971) (an insider is one who has access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the benefit of anyone); *Monsen v. Consolidated Dressed Beef*, 579 F.2d 793, 799 (3d Cir.), *cert. denied sub nom. First Pennsylvania Bank N.A. v. Monsen*, 439 U.S. 930 (1978) (plaintiffs have the burden of establishing that there has been a wrongful act, and that the alleged aider and abettor knew of and substantially assisted in the wrongdoing); *Landy v. FDIC*, 486 F.2d 139, 162-63 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) (an aider and abettor is liable if an independent wrong exists, he knew of the wrong, and substantial assistance was given in effecting it). Rather, the court concluded that if a wrong occurred, on the undisputed facts as a matter of law it did not take place "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b).

The Weavers urge that a fact finder could hold that the Bank's manipulative and deceptive conduct fell within the proscription in section 10(b) because it was in connection with the purchase of a security from the Piccirillos, and also in connection with the sale of a security to the Bank. If they are right on either contention, summary judgment should not have been granted in favor of the defendant. We address those questions separately, starting with the definition of security in the Securities and Exchange Act of 1934 quoted in the margin.[2]

II.

The Piccirillo Transaction

A fact finder certainly could on the record before us find that the Bank's manipulative and deceptive conduct, if it took place, was in connection with the execution and delivery of an agreement between the Piccirillos and the Weavers by which, in consideration of their pledge of a $50,000 certificate of deposit to enable Columbus Packing to obtain a working capital loan, they were given a fifty percent

2. Section 3(a)(10) provides in pertinant part:

(a) When used in this chapter, unless the context otherwise requires —

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity is likewise limited.

15 U.S.C. § 78C(a)(10). As is here relevant, the definition of security is essentially the same as in §2(1) of the Securities Act of 1933, 15 U.S.C. § 77(b)(1). In any event, the definitions have been considered to be virtually identical. *See, e.g.*, United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 847 n. 12 (1975); Tcherepnin v. Knight, 389 U.S. 332, 342 (1967).

interest in the anticipated profits of the Piccirillos' slaughterhouse. Nor is there any question but that the transaction between the Piccirillos and the Weavers would qualify as a sale. The narrower question is whether whatever interest was sold by the Piccirillos falls within one of the categories of securities set forth in section 3(a)(10). It is a settled rule of construction of that definitional section that the categories are not mutually exclusive. "Instruments may be included within any of [the Act's] definitions, as a matter of law, if on their face they answer to the name or description." *Tcherepnin v. Knight*, 389 U.S. 332, 339 (1967), *quoting SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943). More specifically, an interest can be both a certificate of interst or participation in any profit-sharing agreement, and an investment contract. *Tcherepnin v. Knight*, 389 U.S. at 339. We hold that the agreement whereby the Piccirillos and the Weavers each would receive fifty percent of the profits of Columbus Packing could be found by a trier of fact to be either or both.

The classic example of a certificate of interest or participation in a profit-sharing arrangement cited by Professor Loss is a contract whereby the buyer furnishes funds and the seller the skill for speculating in the stock or commodities markets under an arrangement to split any profits. 1 Loss, Securities Regulation 489 (2d ed. 1961). Aside form the brief reference to it in *Tcherepnin*, this clause has not often been considered by the Supreme Court. *Cf. International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558 n. 11 (1979). There are, however, ample applications elsewhere of that clause to arrangements which are quite closely analogous to that before us. *See, e.g., SEC v. Addison*, 194 F. Supp. 709, 721-22 (N.D. Tex. 1961) (written agreements in connection with loans to the effect that defendants would cause contracts to be executed conveying to lenders a percentage interest in profits from defendants' mining operations); *William Tell Productions, Inc.*, Sec. Act Rel. 3852 (1957), 3-4 (fractional interest in a percentage of gross revenues to be realized from an exclusive production of a copyrighted television production). No reason occurs to us why a sale of an interest in the future profits of a slaughterhouse ought to be treated differently. In the cited interest or participation in a profit-sharing agreement cases the interest was offered to more persons than a husband and wife. The nature and

size of the offering, however, bears only on whether the interest sold is exempt from registration under the Securities Act of 1933, not on whether the interest is a security. Section 10(b) of the 1934 Act covers both registered and unregistered securities. The Columbus Packing interest is evidenced by a writing calling for a participation in its future profits derived as a result of the Piccirillos' management of the slaughterhouse. A jury could find that it was a certificate of interest or a participation in a profit-sharing agreement.[3]

In contrast with the profit-sharing agreement clause, the investment contract clause has received a fairly extensive exegesis in the Supreme Court. In the leading case of *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), contracts for the sale of units of land in a citrus grove development, coupled with contracts with the promoter for cultivating, harvesting, and marketing the crop were found to be investment contracts. The crop from the entire grove was to be sold, and the net proceeds distributed to the separate land owner in the proportion that the land of each produced the crop. If there is a difference between a profit-sharing agreement and an investment contract, probably it is in the fact that the latter includes transactions such as that in *Howey*, in which the purchaser did not share the profits on his investment with others, but kept the net proceeds himself. The court capsulized the test for distinguishing an investment contract from a mere commercial or consumer transaction as "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U.S. at 301. In subsequent cases the Court has adhered to this test,[4] although recently the justices have differed as to its application to a specific set of facts. In *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), a majority of the Court held that an investment in a cooperative

3. We speak in terms of what a jury could find since we review a grant of summary judgment. We do not imply that absent some issue of fact raised by the defendant the issue should not be decided as a matter of law.

4. *See* Tcherepnin v. Knight, 389 U.S. 338 (withdrawable capital shares in savings and loan association are investment contracts); International Brotherhood of Teamsters v. Daniel, 439 U.S. at 558 (1979) (noncontributory, compulsory pension plan is not an investment contract). The *Howey* rule was anticipated in SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943).

housing project was not a security. Justice Powell, writing for the Court, quoted the *Howey* test and further stated:

> The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, as in *Joiner, supra* (sale of oil leases conditioned on promoters' agreement to drill exploratory well), or a participation in earnings resulting from the use of investors' funds, as in *Tcherepnin v. Knight, supra* (dividends on the investment based on savings and loan association's profits). In such cases the investor is "attracted solely by the prospects of a return" on his investment. *Howey, supra,* at 300. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or to develop it themselves," as the *Howey* Court put it, *ibid.* — the securities laws do not apply.

421 U.S. at 852-53 (footnote omitted). Here there is no evidence whatsoever in the record that the Weavers wanted to use or develop the Columbus Packing slaughterhouse themselves. It does not appear that they were issuing their obligations to purchase a business they intended to manage.[5] A fact finder could determine that the Weavers made a $50,000 investment motivated primarily by a desire to earn fifty percent of the profits earned by the use of those funds as working capital in a business run by the Piccirillos.

In rejecting the foregoing analysis the dissenting opinion relies on the fact that the Weavers were to obtain use of the Piccirillos' barn and pasture. If a fact finder were to determine that use of the barn and pasture was a primary rather than an incidental purpose of the transaction, it might well decide in favor of Marine Bank. But unlike the dissent we decline to hold that this record compelled that determination as a matter of law.

5. *Cf.* Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973) purchase of franchise accompanied with significant efforts on part of purchaser was not an investment contract).

Since a fact finder could have found that the Bank engaged in manipulative or deceptive acts or practices in connection with the purchase by the Weavers of a contract for a fifty percent share in the profits of Columbus Packing, and could have found that that contract was a certificate of interest or participation in a profit-sharing agreement, or an investment contract, or both, the entry of summary judgment against the Weavers was improper. That conclusion requires a reversal. Because we are remanding for trial it is also appropriate to address the additional question whether the pledge of a certificate of deposit was a sale of a security.

III

The Certificate of Deposit

Certainly if the manipulative and deceptive acts or practices alleged by the Weavers actually occurred, it was in connection with the pledge of the certificate of deposit. Thus those acts or practices are actionable under section 10(b) unless the pledge arrangement was not a sale, or the certificate of deposit is not a security.

Under the 1934 Act the term purchase includes any contract to buy, purchase, or otherwise dispose of, and the term sale includes any contract to sell or otherwise dispose of. 15 U.S.C. § 78c(13), (14). On March 17, 1978, the Weavers executed an assignment reading in part:

> For value received and intending to be legally bound, the undersigned does hereby sell, assign, transfer and set over unto Marine National Bank (hereinafter called "Bank") all the undersigned's right, title and interest in and to a certain deposit account in the undersigned's name in bank described as follows:
>
> Marine Bank Certificate of Deposit #38240 $50,000.00 due February 1984
>
> together with all monies due and to become due thereon, both principal and interest, as security for the payment of a loan in the amount of $50,000.00 . . .
>
> Payment in full of said note shall render this assignment void; otherwise the same shall be and remain in full force and effect.

We have little doubt that if the Weavers had delivered a forged instrument the Bank would contend vigorously that it had made a purchase within the meaning of the 1934 Act, and that the Weavers ought to be prosecuted by the federal government. There is no reason for treating the Weavers' pledge of a valid instrument differently. Thus we agree with those cases in the Second Circuit which have consistently held that a pledge is a sale. *Mallis v. Federal Deposit Ins. Corp.*, 568 F.2d 824, 829-30 (2d Cir. 1977), *cert. dismissed sub nom. Banker's Trust Co. v. Mallis*, 435 U.S. 381 (1978) (pledge is a contract to sell or otherwise dispose of); *United States v. Gentile*, 530 F.2d 461, 466-67 (2d Cir.), *cert. denied*, 426 U.S. 936 (1976) (pledge is a sale), *See also Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1028-30 (6th Cir. 1979). There are contrary expressions in other courts.[6] We do not find them persuasive, if for no other reason than that there is no reason to presume that Congress intended to exclude lending institutions extending credit on the security of pledged collateral from the protection of section 10(b). If a pledge is a purchase for the purpose of protecting a lender it is equally a sale for purposes of protecting the pledgor. Moreover, most of the courts which have intimated that the pledge transaction is not a sale have conceded that its foreclosure is.[7] In this case since the Bank is the issuer of the certificate of deposit, foreclosure, if it is permitted, will take the form of a mere refusal to honor the certificate of deposit, and the setting off of the liability against the Columbus Packing debts. We conclude that on this record a fact finder could hold that a sale of the Weavers' certificate of deposit occurred.

6. *See, e.g.*, Lincoln Nat'l Bank v. Herber, 604 F.2d 1038, 1044 (7th Cir. 1979); National Bank of Commerce of Dallas v. All American Assurance Co., 583 F.2d 1295, 1299-30 (5th Cir. 1978); Reid v. Hughes, 578 F.2d 634, 638 (5th Cir. 1978); McClure v. First Nat'l Bank of Lubbock, Texas, 497 F.2d 490, 495-96 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975); Rispo v. Spring Lake Mews, Inc., 485 F. supp. 462, 467-68 (E.D.Pa. 1980).

As the dissent correctly notes, the Supreme Court has granted certiorari on the question of whether a pledge of stock to a bank as collateral for a bank loan is an offer of sale for a security under § 17(a) of the Securities Act of 1933. Rubin v. United States, 48 U.S.L.W. 3662 (1980), *granting cert. to* United States v. Rubin, 609 F.2d 51 (2d Cir. 1979).

7. *See, e.g.*, Lincoln Nat'l Bank v. Herber, *supra;* McClure v. First Nat'l Bank of Lubbock, Texas, *supra.*

That leaves the question whether the certificate of deposit was itself a security. We note at the outset that it was issued by Marine Bank. That fact is significant only for purposes of section 3(a)(2) of the Securities Act of 1933, which exempts from its registration requirements securities issued by banks whose issues are regulated by federal or state banking officials. 15 U.S.C. § 77c(a)(2). However, bank securities are not exempt from the antifraud provisions of the 1934 Act. *See* 2 Bromberg & Lowenfels. Securities Fraud & Commodities Fraud. § 6.5(312), at 136.1 (1979).

We can in this case also exclude the exception in the 1934 Act's definition of security for currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months . . ." 15 U.S.C. § 78c(a)(10). The certificate of deposit pledged by the Weavers was certainly not currency. Furthermore, since the issuing bank had no obligation to pay for six years, it did not qualify for the nine month commercial paper exception.

In *Tcherepnin v. Knight,* 389 U.S. 332 (1967), referred to above in our discussion of investment contracts and profit sharing agreements, the Supreme Court held that withdrawable capital shares in a savings and loan association were securities. From an investor's standpoint those shares were the functional equivalents of certificates of deposit, except, perhaps, for the fact that the savings and loan in *Tcherepnin* was a mutual institution in which the depositors had an interest in profits. Here, Marine Bank's obligation is to pay a sum certain and a fixed interest return. It is in form and in fact a long term debt obligation. Although, technically, *Tcherepnin* is not controlling, functionally, from the depositor's standpoint, it is hard to distinguish long term deposit transactions with mutual institutions from similar deposit transactions with banks operated for the profit of stockholders. Moreover, when the Court wrote *Tcherepnin* it must have been aware that the Administrator of National Banks in a Statement of Policy on Advertising for Funds by National Banks, 31 Fed. Reg. 16581 (1966), endorsed the SEC's view that deposit and share accounts of banks are subject to the antifraud provisions of the securities laws. *See* 1 Bromberg & Lowenfels, Securities Fraud & Commodities Fraud, #4.6(382), at 82.15. Finally, we note that the Securities and

Exchange Commission has taken the position that certificates of deposit issued by banks are securities.[8]

Since there is no general antifraud exception for bank securities, and since when Marine Bank borrowed for more than nine months it issued what in all material respects is the functional equivalent of any other corporation's bond or note, we cannot on this record hold that a certificate of deposit evidencing its debt is not, like other long term bonds or notes, a security.[9] Perhaps at trial some distinguishing features may be developed. But certainly on the record before us it was error to grant summary judgment against the Weavers on the ground that the manipulative acts and practices of which they complain were not made in connection with the purchase or sale of a security. As did the court in *Bellah v. First National Bank of Hereford, Texas*, 495 F.2d 1109, 1116 (5th Cir. 1974), we remand "so as not [to] foreclose them from an opportunity to pursue that theory of liability in the district court . . ."

IV.

Other Considerations

A few words are appropriate with respect to the district court's approach to the proper interpretation of the Securities Act of 1934. Throughout the court's opinion granting summary judgment there is a general tone of nostalgia for the days when victims of fraud were relegated to the common law remedy of deceit, and when such actions were tried in state courts under state law standards. This interpretation of the Act is grudging of coverage and is fundamentally at variance with the decision made by Congress in 1934 to place a *national* floor under the level of conduct to which parties dealing in the national investment market might descend. The 1934 Act defines securities so

8. *See* MacKethan v. Peat, Marwick, Mitchell & Co., 439 F. Supp. 1090, 1094 (E.D.Va. 1977), referring to the amicus curiae brief of the Securities & Exchange Commission filed in Burrus, Cootes & Burrus v. MacKethan, 537 F.2d 1262 (4th Cir. 1976).

9. We do not rely on the language "certificate of deposit, for a security" in section 3(a)(1). That language refers to a type of security irrelevant to the issues in this case.

broadly as to include virtually every transaction in which an investor might expect to receive a return on his money. It proscribes misconduct not in terms merely of common law fraud subject to all the vagaries of state law, but in the all-inclusive terms "manipulative acts and practices in connection with a purchase or sale" of a security. Most significantly, it provides in section 27 of the Act, 15 U.S.C. § 78aa, one of those comparatively rare instances in which federal jurisdiction is made exclusive. The message is clear that the federal courts have been given a very special responsiblity for overseeing the level of permissible conduct in securities transactions. The reason for the congressional decision is equally clear considering the doleful pre 1934 history of securities transactions during which Congress, dependent upon state common law remedies for regulation of the level of conduct in securities transactions, watched standards of fiduciary duty and of representations in the market place descend to the level tolerated in the most tolerant jurisdiction.[10] Given the special responsibility entrusted to them, the federal courts ought to interpret the 1934 Act with a presumption of coverage of any transaction which Congress did not expressly exclude. This is especially so when it is remembered that the state courts cannot enforce section 10(b), and thus that the Supreme Court will lack appellate jurisdiction to consider, when a trial is finally concluded in a state court, whether the underlying transaction offended national policy. 28 U.S.C. § 1257.

The federal exclusivity of the section 10(b) remedy is, moreover, a compelling reason why pendent state law claims ought to be heard in the federal court as well, even in states where state law would afford as much or more relief. *See, Cotler v. Inter-County Orthopaedic Association, P.A.*, 526 F.2d 537 (3d Cir. 1975). Thus we must also reverse the district court's dismissal of the pendent state law claims, so that the trial court may reconsider whether their trial should be held in the same tribunal which must consider the section 10(b) claim.

10. *See* A.A. Berle and G.C. Means. The Modern Corporation and Private Property (1932).

V.

Conclusion

The order appealed from, granting summary judgment on the Weavers' section 10(b) claim, and dismissing their pendent state law claims will be reversed, and the case remanded for further proceedings.

Weis, *Circuit Judge*, dissenting.

It should come as no surprise that the panel is divided on the issues in this case because what constitutes a security under the 1933 and 1934 Acts is a matter which continues to trouble courts and commentators. There is no disagreement here about the facts or the inferences that can be drawn from them, except as they shed light on the preliminary clause of the definitions in § 3(a)(10) of the Security Exchange Act: "unless the context otherwise requires." 15 U.S.C. § 78c(a)(10) (1976).

I.
THE PICCIRILLO TRANSACTION

The majority concludes that the interest sold by Piccirillo falls within one of the categories of security set forth in § 3(a)(10), but I am unable to accept that proposition based upon the facts of this case. The agreement here provided that in consideration for agreeing to act as co-obligor on Piccirillo's loan from the bank, Weaver would have the right, as long as Piccirillo was operating and in possession of the Columbus Packing premises:

1. To use the barn and pasture on the packing house premises at the discretion of Piccirillo;

2. To receive 50% of the "adjusted net profits" of the Columbus Packing Company so long as Weaver remained a co-obligor;

3. To receive $100 per month until the bank loan was repaid.

Piccirillo also agreed not to borrow additional money without prior consultation and approval by Weaver.

Certain preliminary observations are in order. The agreement obviously is not in a standard form that could be issued to the public at large. It was tailored to the unique circumstances of the parties, *i.e.*, use of the barn and pasture, as well as Weaver's personal approval of further borrowings. There was no public offering by Piccirillo, but rather a purely private arrangement among individuals — Piccirillo, Weaver, and their spouses — involving no public market or exchange.

Even if the written agreement between the parties could be characterized as a "certificate of interest" or a profit sharing arrangement, it does not follow that the Securities Exchange Act applies. In an analagous situation we held that the statutory definition of a security embracing "every note" cannot be read literally and in context, a "note" may be without the statute. *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973). Similar reasoning requires that the Piccirillo agreement be examined in context to determine if the transaction, however labeled, is within the scope of the Act.

In construing the Securities Act of 1933, 15 U.S.C. § § 77a-77aa (1976), the Supreme Court noted that "courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943) (footnote omitted).

Some years later, the Court emphasized that the focus of the Act is on the sale of securities to raise money for profitmaking purposes, on the exchanges on which securities are traded, and on the need for regulation to prevent fraud and protect investors. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 (1975). Thus, while the statutes are to be construed liberally, application is to turn on the economic realities underlying a particular transaction. *Id.* at 851-52. And as we cautioned in *Lino* "not every plan generating allegations of fraud is a violation of federal securities law." 487 F.2d at 695.

The majority believes that the Piccirillo agreement comes within the Exchange Act designation of an investment contract. In *United Housing Foundation, Inc. v. Forman*, the court reaffirmed the explanation of the type of security that it had discussed in *SEC v. W. J. Howey Co.*, 328 U.S. 293, 301 (1946). Describing its formulation as a "shorthand form . . . [of] the essential attributs," the Court defined an investment contract as "an investment of money in a common enterprise with profits to come solely from the efforts of others." 421 U.S. at 852. Application of that definition to the circumstances present here raises two issues: first, whether a "common enterprise" existed when

only two parties were involved in the transaction;[1] and secondly, were the "profits" to come solely from the "efforts of others" when part of the consideration recited was Weaver's right to use Piccirillo's barn and pasture.

Although a security was found to exist in *Howey*, several significant facts in that case contrast starkly with the circumstances at hand. In *Howey*, there was a public offering, an advertising program, sales to persons who were not residents of the state, and, during a 28 month period, purchases by 42 persons. Similarly, in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), where the Court found capital shares in a savings and loan association to be an investment contract within the Securities Exchange Act, the plaintiff class consisted of more than 5,000 investors.

When the number of participants was much smaller, a different result has been reached. The Court of Appeals for the Seventh Circuit in *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 100 (7th Cir. 1977), concluded that the requirement of a common enterprise includes both multiple investors and a pooling of their funds. In that case, an arrangement through which individual investors deposited funds with a commodity broker in separate discretionary accounts for investment in a profit sharing arrangement was held to be neither an investment contract nor a profit sharing plan within the Securities Act. *Wasnowic v. Chicago Board of Trade*, 352 F.Supp. 1066 (M.D. Pa. 1972), *aff'd mem.*, 491 F.2d 752 (3d cir.), *cert. denied*, 416 U.S. 994 (1974). *Cf. SEC v. continental commodities corp.*, 497 F.2d 516 (5th Cir. 1974) (multiple investors but no pooling).

The rationale employed by the Seventh Circuit in requiring multiple investors to satisfy the commonality requirement is persuasive, and I would follow *Hirk* for that reason alone. But even more compelling is that the result is in keeping with the general purpose of the Securities

1. In Pennsylvania, property owned by husband and wife is considered to be held as a tenancy by the entireties and the interest of husband and wife considered as one. *In re Holmes Estate*, 414 Pa. 403, 406, 200 A.2d 745 (1964). Hence, both Piccirillos owned the business as tenants by the entireties and the guaranty by the obligors was an entireties obligation.

Exchange Act — to regulate the securities markets where the public trades, and to scrutinize the various arrangements which are offered to the public as investments, *United Housing Foundation, Inc. v. Forman, supra* at 837. In the case at bar, no widespread public interest is affected.[2]The transaction was a face to face encounter involving two parties who made a loan agreement. *See Great Western Bank and Trust Co. v Kotz,* 532 F.2d 1252, 1262 (9th Cir. 1976) (Wright, J., concurring). Here there is no distribution of a widely offered instrument commercially known as a security, as is the case with the various schemes involving transactions regulated by the Act. *See e.g., SEC v. C.M. Joiner Leasing Corp., supra* at 352-53; *Hirk v. Agri-Research Council, Inc.,* supra at 103; *SEC v. Koscot Interplanetary, Inc.,* 497 F.2d 473 (5th Cir. 1974). In addition, there is no suggestion that the laws of Pennsylvania do not provide for an appropriate resolution of the dispute in this case. Indeed, as the majority notes, the plaintiff included pendent state claims in his complaint.[3]

The second issue, whether the profits were to come from the sole or essentially management efforts of others, *see SEC v. Glen W. Turner Enterprises,* 474 F. 2d 477 (9th Cir. 1973), is not per se as important a factor in this case. Were that issue standing alone, I would be inclined to

2. *See* FitzGibbon, What is a Security? A Redefinition Based on Eligibility to Participate in the Financial Markets. 64 MINN. L. REV. 893 (1980).

3. The Pennsylvania Securities Act provides:

"It is unlawful for any person in connection with the offer, sale or purchase of any security . . . (a) to employ any device, scheme or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person."

PA. STAT. ANN. tit. 70, § 1-401 (Purdon Supp. 1980).

The Pennsylvania definition of a "security", 70 PA. STAT. ANN. tit. 70, § 1-102, is broader than that in the federal acts and is not preceded by the phrase "unless the context otherwise requires."

follow the philosophy of the court in *Safeway Portland Employees Federal Credit Union v. C.H. Wagner & Co.* 501 F.2d 1120 (9th Cir. 1974), and apply the "package" concept to the various benefits that Weaver was to receive. There, the court held that the sale of interest bearing certificates of deposit, combined with a bonus agreement to pay additional interest on the transaction, was an investment package that qualified as a security. *Id.* at 1122.

If the other circumstances of the case at hand were not involved, the 50% share of the profits would carry the day on a similar basis. But more weight being given to Weaver's right to Piccirillo's barn and pasture is warranted when the arrangement is viewed in toto. Obviously, that benefit was of more value to Weaver than it would be to an out of state resident or to a person who had no connection with cattle raising. It is more in the nature of a "personal use" accomodation, shaped to fit the particular needs of the private parties involved. Thus, the arrangement between Weaver and Piccirillo does not have an equivalent money value to all persons, another characteristic generally attributable to true securities. *See United Housing Foundation, Inc. v. Forman, supra* at 851. Moreover, when this factor is added to the lack of such features as common enterprise, use of a public market, public offering, and need for federal regulation, the conclusion is inescapable that the transaction between Weaver and Piccirillo does not qualify as a security within the meaning of the Securities and Exchange Act.

II.

THE CERTIFICATE OF DEPOSIT

Section 3(a)(10) of the 1934 Act includes among its definitions of security, "certificate of deposit, for a security." The majority is correct in not relying on this language as a basis for its finding that the certificate of deposit under scrutiny here falls within that clause. The certificate in this case is an entirely different obligation, being a type of time deposit with a bank, rather than a receipt for a security as that term is used in the statute.

The majority does rely to some extent on the fact that the certificate is not due until six years after issuance, and that the Act's exclusion of obligations having a maturity of less than nine months is therefore

inapplicable. The negative inference that the certificate is a security because it is not expressly exempted, however, is not determinative. That is, a note payable in less than nine months may be a security in some situations while a similar obligation of a longer maturity may be outside the Act's ambit in other cases. *McClure v. First National Bank of Lubbock*, 497 F.2d 490, 495 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975).

Nor do I believe that *Tcherepnin v. Knight, supra*, holding that withdrawable capital shares in a savings and loan association were securities, controls here. In the majority's view, from the depositor's standpoint the certificate of deposit is functionally equivalent to savings and loan shares. I do not find that argument persuasive because *Tcherepnin* stressed two important considerations—the shares did not entitle the holders to a fixed rate of return but only a share of the profits, and secondly, the shares were transferable. Moreover, the court cited legislative history supporting its position that savings and loan associations were to be governed by the anti-fraud provisions of the Securities Act. Unlike *Tcherepnin*, no such references can be made to certificates of deposit of a commercial bank. In addition, the Marine Bank certificate bears a fixed rate of interest and represents the bank's obligation to pay a long term debt. It therefore is more akin to a savings account than to the bank's capital stock.

The courts of appeal are not unanimous in their approach to certificates of deposit. In *Bellah v. First National Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974), the Fifth Circuit distinguished *Tcherepnin* and concluded that on the record before it, a certificate of deposit was not a security. In *Safeway Portland Employees Federal Credit Union v. C. H. Wagner & Co., supra*, the Ninth Circuit held that a combination of a certificate of deposit, which it assumed arguendo was not a security, and a "bonus" would come within the Securities Act.

The Seventh Circuit decided that a certificate representing a currency deposit in a commercial bank, such as that present here, was not a security or investment transaction. *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F.2d 465, 470 (7th

Cir. 1980). As here, the complaint in *Fingland* failed to include a copy of the document upon which jurisdiction was premised. However, despite the absence of the certificate of deposit, the court was able to distinguish the commercial instrument relied upon there and the investment transaction found in *Tcherepnin.* As the court aptly noted, if *any* document labeled certificate of deposit were a security, "there would no longer be any validity to the distinction between commercial and investment transactions since any depositor in a failed bank could claim the same protection accorded security holders." *Id.*

Taking a different approach, in *SEC v. First American Bank & Trust Co.*, 481 F.2d 673, 678 (8th Cir. 1973), without discussion, the court said that "capital notes, certificates of investment, and passbook savings accounts" in a bank were securities within the scope of the Securities Act. In a footnote, the court referred to the language in the 1933 Act "Any note [or] evidence of indebtedness." The last clause, it must be noted, is not included in the definition in the Securities Exchange Act of 1934, the applicable statute in this case.

Contrary to the implication in the majority opinion, there is a difference between a certificate of deposit issued by a commercial bank and a debt obligation of a corporation in some other line of endeavor. The bank is in the business of borrowing and lending money. With the exception of finance companies and others of that nature, however, corporations generally borrow money to generate capital necessary for costs of operation. Furthermore, bank borrowing and lending activities are closely regulated by designated governmental agencies. Because of this supervision, the need to protect depositors under the Securities Exchange Act is not as apparent as it is with nonbanking entities. This philosophy is also reflected in the many cases that have found bank loans based upon promissory notes not within the scope of the Act; *McClure v. First National Bank of Lubbock, supra* at 492-93: *Bellah v. First National Bank of Hereford, supra.*

The American Law Institute shares this view, for its proposed Federal Securities Code specifically excludes from the definition of security an interest in a deposit account with a bank, and "a bank

certificate of deposit that ranks on a parity with an interest in a deposit account with the bank." ALI FED. SECURITIES CODE, § 299.53(b)(5) (Mar. 15, 1978 Draft). As the Committee comments, "although literally one may find an "evidence of indebtedness" or (when interest is paid) an "investment contract," it seems logical to exclude these interests along with traditional insurance policies and annuity contracts form the definition of "security." The exclusion extends to savings and checking accounts, as well as time and demand deposits, but not to custody accounts. The proposed exemption does not apply to savings and loan associations in recognition of the distinction between *Tcherepnin*-type interests and the usual commercial bank transactions.[4]

Since I would hold that the certificate of deposit was not a security, I need not address the issue of whether a pledge constitutes a sale, a point of conflict between the circuits that may soon be resolved by the Supreme Court. *United States v. Rubin*, 609 F.2d 51 (2d Cir. 1979), *cert. granted*, 48 U.S.L.W. 3662 (1980) (No. 79-1013).

It is obvious I do not share the majority's view that the 1934 Act was intended to cover virtually every transaction in which an investor might expect to receive a return on his money. *See, e.g., Glick v. Campagna*, 613 F.2d 31, 35 n.3 (3d Cir. 1979); *Collins v. Signetics Corp.*, 605 F.2d 110, 113 (3d Cir. 1979). Although the Securities Act should be interpreted liberally to carry out its purposes, we should also heed the admonition in *Woodward v. Metrobank of Dallas*, 522 F.2d 84, 90 (5th Cir. 1975), "The court must ask whether the conduct in a case before it was the type of behavior meant to be forbidden by the Securities Acts, remembering that business transactions are not all reducible to a purchase or sale of a security." Nor should we "convert § 10(b) of the Securities Act into a source of general federal jurisdiction." *Great Western Bank & Trust Co. v. Kotz, supra* at 1253.

4. I realize, of course, that it can be argued that the ALI proposal is an indication that the drafters believe that the bank certificate presently comes within the definition in the Exchange Act. Nevertheless, I am more impressed with the implication in the ALI view that inclusion of bank certificates of deposit within the scope of the Securities Act is unnecessary.

I do not believe that the transactions in the case at hand come within either the spirit or intent of the Securities Exchange Act and accordingly, I dissent.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

SAMUEL WEAVER and ALICE WEAVER,
Appellants

v.

MARINE BANK

ON APPEAL FROM THE UNITED STATES DISTRICT OFFICE
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

(D.C. Civil No. 79-0066)

Argued: September 18, 1980

Before: GIBBONS, WEIS and SLOVITER, *Circuit Judges*

(Opinion Filed: December 15, 1980

ORDER AMENDING OPINION

The slip opinion in the above matter is hereby amended as follows:

Page 6 n.2, Flush Material, First Line:

"15 U.S.C. § 78C(a)(10)" is amended to read "15 U.S.C. § 78c(a)(10)"

Page 14, Line 7:

"#4.6(382)" is amended to read "§ 4.6(374)"

JOHN J. GIBBONS
Circuit Judge

Dated: January 28, 1981

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and
ALICE WEAVER, *Plaintiffs*

v. Civil Action No. 79-66 Erie

MARINE BANK,
Defendant

MEMORANDUM AND ORDER GRANTING MOTION FOR SUMMARY JUDGMENT

The complaint in this case was filed May 4, 1979. In due course, the answer was filed. Thereafter the parties had rather extensive discovery. Interrogatories were filed, and several depositions were taken, particularly of the two plaintiffs, and at least two of the employees of defendant who were involved in this transaction. In accordance with our practice, the case was noticed for pretrial conference. But in the meantime, on December 14, defendant filed a motion to dismiss the complaint or for summary judgment. Accompanying that motion were affidavits of two employees of defendant. On December 18, 1979, plaintiff filed an answer to defendant's motion for summary judgment.

Counsel have been heard at oral argument on the issues raised in the motion for summary judgment. Under Rule 56, it has been conluded that based upon the pleadings, depositions, answers, answers to interrogatories, admissions, and affidavits, it appears certain that there is no genuine issue as to any material fact and that defendant is entitled to judgment as a matter of law on the issue as to whether this Court has subject matter jurisdiction. Counsel for plaintiffs is experienced and able. He knows how to aver jurisdiction in the Federal Courts. But in the first numbered paragraph of the complaint he names the plaintiffs and says, ". . . having a place of residence at R.D. #4, Union City, Erie County, Pennsylvania, 16438," without averring any citizenship with respect to either plaintiff. There is no question but what the bank is a Pennsylvania corporation with its

principal place of business in the City of Erie in this judicial district. But, nevertheless, it appears from matters outside the pleadings that both plaintiffs are as a matter of fact citizens of Pennsylvania with the result that there can be no jurisdiction in this case under the diversity statute. Thus the only jurisdiction in this Court as averred in the complaint must be premised upon the Securities and Exchange Act, 15 U.S.C.A. 78 (aa), and its amendments and the rules of the Securities and Exchange Commission. The point is, however, that plaintiffs say they purchased a security in the Columbus Packing Company which is within the definition of "security" as that term is defined in 15 U.S.C.A. 78 (c)(a)(10). Defendant, of course, denies that there was any security involved in the transaction between these parties and as alleged in the complaint.

A careful examination of the issues as revealed in all the documents in this case has satisfied me that the defendant is correct in its contention. In the first place, plaintiffs say in an affidavit attached to their answer to the motion that on February 28, 1978, they were co-owners of a $50,000 certificate of deposit, which had been purchased at the Corry office of the Marine Bank. The reason for the purchase, they said, was "... for purposes of having money available for the operation of our livestock auction . . ." in the Union City, Pennsylvania, area. Attached to the complaint is a document executed by the Weavers in which it is recited that Columbus Packing Company, hereinafter "Piccirillo", was about to enter into an agreement with Marine Bank for a loan of $50,000, and the Weavers in the document agreed to become co-obligors on a loan to be extended by the Marine Bank to Piccirillo. But this instrument defined the rights of the Weavers in the Piccirillo operation. For instance, Weavers had the right to use the barn and pastures on the Columbus Packing Company premises. They were to receive 50% of the profits, and they were to receive $100 per month salary until such a time as the obligation was paid in full by Piccirillo. It is certain that this document was not known to anyone in the bank at the time of the transaction complained of by the plaintiffs in this case. (See Weavers' depositions.)

In the complaint plaintiffs' counsel says the document just recited, Exhibit A, was the purchase by plaintiffs of a security transaction. Complaint, Para. 7. The remaining paragraphs of the complaint

generally speaking aver deception on the part of the bank with respect to the disposition of the $50,000 certificate of deposit, which was hypothecated by the Weavers as security for the loan. General fraud is alleged on the part of the bank employees to induce Weavers to secure the loan by the $50,000 deposit. But in the answer to defendant's motion for summary judgment, counsel for plaintiffs indicates in paragraph 2, that plaintiffs purchased a second security on March 17, 1978, in connection with the transaction. In any event, in the answer to the motion it is contended that there are genuine issues of material facts as to whether the defendant, Marine Bank, violated Section 10(b)5 of the 1934 Securities and Exchange Act and Section 17(a) of the 1933 statute," . . . in connection with the purchase and sale of the aforementioned securities, causing the Weavers' at least $50,000 in damage . . ."

The forerunner to the bank loan was the agreement between Piccirillo and Weavers that the latter would become co-obligors on the proposed bank loan. It is inherent in this instrument that these people knew that Weavers had $50,000 to back up the obligation to the bank. Counsel for Weavers claims this was a security transaction within the meaning of the statute. I disagree. In this deal, Weavers simply become co-obligors on the bank note for a consideration. The latter being the rights retained by them including the salary.

As the Court reads counsel's brief and answers, there is some confusion with respect to the certificate of deposit. Counsel says this was the purchase of a second security, but that was in existence prior to any transaction between the Weavers and the bank. They say they owned the certificate on February 28, 1978. It is certain that all the other documents were executed on March 17, 1978, and that the deposit was to secure the bank for the loan mentioned in their agreement with Piccirillo. The bank deposit cannot be considered a security. In the complaint generally, aside from whether the transaction was a security transaction, plaintiffs aver a general cause of action for relief from the bank based on issues which are generally determined under the diversity jurisdiction. These issues are raised in Counts 2 and 3 of the complaint with the averment that they are under the pendent jurisdiction of the Court. But see Judge Hunter's opinion,

Lentino and Flame v. Fringe Employee Plans, Inc., No. 78-1110, decided December 18, 1979. No diversity jurisdiction is averred in this case.

Mr. Conner, for plaintiff, is attempting to make a federal case out of this situation. But this Court can find no subject matter jurisdiction under the statute involved. Thus the alleged pendent jurisdiction fails. Certainly the issues raised show that the transaction was nothing more than an ordinary commercial transaction entered into by borrowers and co-obligors such as Weavers with security given the lender by one of the co-obligors, that is, the Weavers, plaintiffs in this case. As indicated, the briefs have been considered. This is an issue which has been reviewed by a host of district courts and courts of appeal with respect to a transaction of this kind. I have concluded that the brief of defendant covers the facts and the law of this case. I find no genuine issue as to any material facts with respect to the lack of jurisdiction in this Court under the statute. The defendant's brief explains my reasons for the decision in this case. It is comprehensive and authoritative. It is annexed hereto as Appendix A and made a part of this memorandum.

The motion for judgment is granted.

JUDGMENT ORDER

AND NOW, January 11, 1980, pursuant to Rule 56, based upon the pleadings, depositions, answers to interrogatories, admissions, affidavits, and all other documents in this case and upon consideration of the oral arguments of counsel and their briefs; this Court is satisfied that there is no genuine issue as to any material fact, and, therefore, defendant is entitled to judgment as a matter of law. Defendant's motion for summary judgment is granted. Judgment is Directed to be entered for defendant, Marine Bank, and against the plaintiffs, and this civil action is dismissed.

IT IS SO ORDERED.

JOSEPH P. WILLSON,
Senior District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and
ALICE WEAVER

v. Civil Action No. 79-66 Erie

MARINE BANK

ORDER CORRECTING ERROR

AND NOW, January 28, 1980, counsel for defendant, Marine Bank, by letter called my attention to the inadvertent error with respect to Appendix "A" attached to my Memorandum and Order for Judgment filed January 11, 1980. In that Order pursuant to Rule 56, defendant's motion for summary judgment was granted. In the last page of the Memorandum, I stated in part:

> "The defendant's brief explains my reasons for the decision in this case. It is comprehensive and authoritative. It is annexed hereto as Appendix A and made a part of htis memorandum."

However, rather than the brief of the defendant filed by McClure, Dart, Miller, Kelleher & White, Esquires, attorneys for defendant, plaintiff's brief filed by Dunn and Conner, Esquires, was attached. This is an obvious error, and Appendix "A" attached to my Memorandum of January 11, 1980, is deleted and set aside; and attached hereto and made a part of my decision in this case is defendant's brief marked Appendix "B".

IT IS SO ORDERED.

JOSEPH P. WILLSON,
Senior District Judge

(APPENDIX "B" TO JUDGE WILLSON'S OPINION)

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and
ALICE WEAVER

v. **Civil Action No. 79-66 Erie**

MARINE BANK

BRIEF OF MARINE BANK IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

I. STATEMENT OF FACTS

On or about March 17, 1978, Marine Bank entered into a loan with Columbus Packing Company, a proprietorship owned by Raymond A. Piccirillo, Jr. and his wife, Barbara J. Piccirillo. (Affidavit Santom, par. 1 and Exhibit D thereto). This note was co-signed by Raymond A. Piccirillo, Sr. and Mary T. Piccirillo (Affidavit Santom, par. 4 and Exhibit D thereto). As additional security for the loan the plaintiffs, Sam (a/k/a Ezra) and Alice Weaver signed an agreement of guaranty and pledged a $50,000.00 certificate of deposit as collateral. (Complaint, par. 8; Complaint Exhibit B). Some time prior to March 17, 1978, the Piccirillos and the Weavers entered into an "Agreement" under which Weavers were to receive 50% of the "adjusted net profits" of Columbus Packing Company along with other financial arrangements. (Complaint, par. 7; Complaint Exhibit A). The Marine Bank was not informed of this "Agreement" and knew nothing about it. (Affidavit Santom, par. 5-8; Affidavit Daggett, par. 3-6; Depo. E. Weaver, p. 29 and p. 52; Depo. A. Weaver, p. 60-61).

Columbus Packing Company filed a Petition in Bankruptcy on or about July 21, 1978 and has been adjudicated a bankrupt. (Complaint, par. 16).

Plaintiffs instituted the above action, alleging a violation of the anti-fraud provision of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. 240.10b-5 alleging the Bank employed manipulative and deceptive devices to induce them to enter into the Agreement attached to the complaint as Exhibit A.[1]

II. ARGUMENT

A. The guarantee of the plaintiffs of the payment of note to Marine Bank dated March 17, 1978 is not a "security" as defined in the Securities Exchange Act of 1934, 48 stat. 891, 15 U.S.C. § 78j(b) and the Securities and Exchange Commission's rule 10b-5, 17 C.F.R. 240.10b-5.

Plaintiffs have alleged a violation of the anti-fraud provisions of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. § 240.10b-5. These sections generally prohibit engaging in fraud in connection with the purchase or sale of a security. It is the position of the Marine Bank that an essential element of the alleged offense is the purchase or sale of a "security" and that, in the instant case, there has been no purchase or sale of a security.

Plaintiffs acted as guarantors of a loan by Marine Bank to Raymond A. and Barbara J. Piccirillo, d/b/a/ Columbus Packing Company. The note was dated March 17, 1978 in the amount of $65,000.00 and was co-signed by Raymond A. and Mary T. Piccirillo, Sr., the parents of Raymond. As guarantors, plaintiffs signed a guaranty agreement and hypothecated a $50,000.00 certificate of deposit as collateral. This constituted the entire transaction between the plaintiffs and the Bank.

A 10b-5 action cannot be predicated on the guarantee of the note because the note is not a "security" as defined in the 1934 Act. A security is . . .

1. A related case was Raymond A. Piccirillo, Sr. and Mary T. Piccirillo v. Marine Bank (W.D. Pa. NO. 78-85 Erie) in which judgment was entered in favor of defendant on February 8, 1979.

> "unless the context otherwise requires — any note..." Securities and Exchange Act of 1934, 48 Stat. 882, 15 U.S.C. § 78c (a) (10).

Despite the "any note" language of the Act, the Third Circuit is aligned with the Fifth, Seventh, and Tenth Circuits in holding that not every note is a "security".[2] Instead, these Circuits consistently hold that notes executed in ordinary commercial — as opposed to investment — transactions are exempt from the Securities Acts. These decisions are based on the Congressional purpose in enacting securities acts and the statutory preface to the definitional section quoted above as "unless the context otherwise requires". Such case law developed due to a series of lawsuits, like the present, wherein plaintiffs sought to invoke federal jurisdiction over ordinary commercial notes simply because fraud is easier to prove under § 10b-5 than under state statutes and the common law.

One of the seminal cases in this area is strikingly similar to the instant case both legally and factually. In *Bellah v. First National Bank of Hereford, Texas,* 495 F 2d 1109 (5th Cir., 1974), plaintiffs borrowed money from the bank to aid them in development of their livestock business. They executed a note, secured by a mortgage on real property. Later, they also deposited a certificate of deposit in the bank. The plaintiffs claimed the bank misrepresented to them that they "need not worry about foreclosure", just as plaintiffs allege Marine Bank did in the instant case. The District Court dismissed the complaint for lack of jurisdiction and the Fifth Circuit affirmed, stating:

> "The record reveals that in extending the loans, the Bank merely intended to aid the [plaintiffs] in the operation of their livestock business. It is bereft of any evidence that the Bank sought to profit from the successful operation of this enterprise . . . We merely hold that notes issued in the context of a commercial loan transaction fall beyond the purview of the Act." 495 F. 2d 1109 at 1113-1114 (5th Cir., 1974).

2. See "Notes Are Not Always Securities", 30 Business Lawyer 763 (1975).

The practical ramifications of including commercial loans under the 1934 Securities Act were also discussed by the *Bellah* court when it stated:

> "First, in view of the . . . similitude of the '33 and '34 Acts, notes subject to the anti-fraud proscriptions of the latter would be amenable to the registration provisions of the former. Registration is a costly procedure, both temporally and financially speaking. Subjection of loan transactions involving a promissory note to the registration requirements would inevitably *wreak havoc on the commercial paper market* . . . Second, . . . we doubt that Congress intended by these Acts to render federal judges the guardians of all beguiled makers or payees. Where, as here, complaints are spawned by a commercial loan transaction, recourse must be had to state not federal courts. 495 F. 2d 1109 at 1114 (5th Cir., 1974) (emphasis added).

Bellah was decided also in part by reliance on the Third Circuit decision in *Lino v. City Investing Company*, 487 F. 2d 689 (3rd Cir., 1973). The plaintiff in *Lino* purchased a franchise sales center license agreement, payment to be made in part by a promissory note. The Third Circuit held on a motion to dismiss that the giving of a personal promissory note is not the "purchase" of a "security" within the meaning of 240 C.F.R. 10 (b) (5). The court relied on three factors, all of which are present in the instant case. These were (1) the alleged fraud arose from a personal promissory note, (2) there was no public offering of the note, and (3) the maker [guarantor] of the note is the person claiming to be defrauded. The court noted that

> "[To] accept [plaintiff's] arguments would mean that any consumer who bought an article 'on time' and issued a note would be able to sue in a federal court on the theory the retailer had purchased his 'security.' If it had intended . . . to extend federal jurisdiction to transactions of this type, Congress most certainly would have given a real indication of such an intent." 487 F. 2d 689 at 695 (3rd Cir., 1973).

The commercial/investment dichotomy was reaffirmed by the United States District Court for the Eastern District of Pa. in *Provident*

National Bank v. Frankford Trust Co., 468 F. Supp. 448 (E.D. Pa., 1979). A participating bank in a loan participation agreement sued the lead bank in that case to recover for alleged 10b-5 violations. Pursuant to a motion to dismiss, the court held the loan participation agreement was neither a "security" nor an "investment contract". The court looked to two important factors. First, the lead bank did not exercise managerial efforts over the project. In the present case, plaintiffs have not alleged that Marine Bank acted in a managerial capacity over Columbus Packing. Secondly, as in the present case, there was no public offering. The lead bank in *Provident*, like Marine Bank, had no entrepeneurial interest in the project in the sense that they would generate the return expected by the parties to the participation agreement. Marine Bank was not involved in the meat slaughtering business but simply made a commercial loan. Any profits were to be generated by the Piccirillos, not Marine Bank . Thus the loan by the Bank was not an investment.

Similar reasoning was applied to the guarantor of a note in *Emisco Industries, Inc. v. Pro's, Inc.*, 543 F. 2d 38 (7th Cir., 1976). In *Emisco*, the plaintiff subsidiary corporation purchased assets of the defendant in part by a promissory note guaranteed by its parent corporation. The parent and the subsidiary brought action under 10b-5, arguing the transaction was investment in nature. The court held the transaction was essentially commercial in nature because the defendant, like the Marine Bank, expected the subsidiary to pay off the note and, if it failed, for the guarantor to pay it off. In other words, the Bank expected to be paid whether the business was successful or not. As stated in *Emisco*,

> "This was the natural expectation (as for any loan), whether or not plaintiffs achieved profits on any of their businesses."

Another case similar to the instant case which has been cited with approval in this Circuit is *McClure v. First National Bank of Lubbock, Texas*, 497 F. 2d 490 (1974). The plaintiff in *McClure* alleged that bank loan officers engaged in fraud to induce her to consent to a loan from the bank to her closed corporation and further defrauded her into pledging her corporate stock as collateral. The bank filed a motion to dismiss. The court held that assuming fraud for the purpose

of review, as it had to, there was no subject matter jurisdiction because there was no purchase or sale of a security. The court relied on two factors. The corporate note, like the Marine Bank note, was not offered to investors. Secondly, like the Marine Bank note, it was not acquired by the bank for speculation or investment. The proceeds of the loan were used so that the corporation could pay off its *business debt*. Thus, the court concluded, the corporation did not obtain investment assets in exchange for its note. This court has already found in a related case that the proceeds of the Marine Bank loan to Columbus Packing were used entirely to pay off business debts. See *Piccirillo v. Marine Bank* , C. A. No. 78-85, Erie (W.D. Pa., 1979). Thus, the note was not an investment contract.

The implications of bringing the present case under the purview of the 1934 act are even clearer if the situation is viewed in reverse. Can a bank sue under 10b-5 any debtor who allegedly misrepresented his or her financial position? Could Marine Bank sue Mr. Piccirillo or Mr. Weaver under 10b-5? This was the situation in *Tri-County State Bank v. Hertz*, 418 F. Supp. 332 (M.D. Pa., 1976), where the bank sued a debtor corporation under 10b-5, stating the corporation misrepresented its financial position. The court, relying on *Bellah, Lino* and the *McClure* cases, held the bank had received commercial paper and not investment securities. The following elements were present: (1) the note was a demand note and could be called in at the first sign of insolvency (like the Marine Bank note); (2) the proceeds of the loan were used to pay business debts and not for capital expenditure or by the use of any entity than the debtor (like the proceeds of the Marine Bank note); (3) the loans arose out of an already existing customer relation and the impetus for the loan came from the debtor who sought working capital (like the Marine Bank loan); (4) the note was on the bank's standard promissory note form (like the Marine note form); (5) the loan was secured (the Marine loan was also); (6) the Bank expected to be paid regardless of the success of the business (as did Marine); and (7) the interest to be paid the Bank was at a fixed rate and did not depend on the profitability of the debtor's business. The court made it clear that although the bank did not realize a full return because of default, that did *not* mean the bank invested risk capital, stating "The 'risky loan' must be extinguished from an investment of 'risk capital'". 418 F. Supp. 332 at 343 (M.D. Pa., 1976).

Finally, the commercial/investment dichotomy has been sanctioned by the United States Supreme Court, which has cited *McClure* and *Lino* with approval. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 44 L. Ed. 2d 621, 95 S. Ct. 2051 (1975).

It is therefore well established that the securities laws are not designed to afford general relief to debtor, guarantor or creditor when commercial loans turn out to have been unwisely made, nor are they a source of general federal jurisdiction. When a transaction is commercial in nature, it is outside the purview of the 1934 Act. For other cases in accord, see: *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.*, 508 F. 2d 1354 (7th Cir., 1975) [motion to dismiss granted when bank loaned business funds secured by a chattel mortgage; nothing in complaint indicated bank invested in or was a co-partner in the enterprise]; *Joseph v. Norman's Health Club, Inc.*, 336 F. Supp. 307 (E.D. Miss., 1971) [promissory note executed in exchange for a lifetime membership in a health club not a security under 10b-5 when debtors allege failure to disclose failing financial condition of club]; *S.E.C. v. Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3 (S. D. N.Y., 1968) [loans by corporation to corporate officers to pay personal obligations fraudulent but not "securities" within the meaning of 10b-5]; *United Sportsfishers v. Buffo*, 396 F. Supp. 310 (D.C. Calif., 1975) [promissory note secured by a second ship's mortgage in a commercial financing venture not a security within the ambit of the securities laws]; *Amfac Mtg. Corp. v. Arizona Mall of Tempe*, 583 F. 2d 426 (9th Cir., 1978) [note given a lender in the course of commercial financing is not a security]; *Avenue State Bank v. Tourtelot*, 379 F. Supp. 250 (N.D. Ill., 1974) [bank loan to defendant who misrepresented its financial picture not a "security"]; *Lincoln National Bank v. Lampe*, 414 F. Supp. 1270 (N.D. Ill., 1976) [bank loan to debtor on basis of five promissory notes and secured by stock certificates later found to be worthless outside purview of 1934 Act].

B. *The guarantee of the plaintiffs of the payment of note to Marine Bank is not "in connection with" the purchase or sale of a security as defined in the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78; (b) and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. 240.10b-5.*

In their complaint, plaintiffs further predicate their 10b-5 action upon a document attached as Exhibit "A" titled "Agreement" (hereinafter "Agreement"). Yet, on its face, this "Agreement" purports to be some sort of side arrangement between Raymond A. Piccirillo, Jr., Barbara G. Piccirillo, Samuel Weaver and Alice F. Weaver. The Marine Bank is not a party or witness to this Agreement. It is the position of the Bank that if, in fact, this Agreement could constitute a "security" as defined in the 1934 Act, there is no connection as matter of law between the Bank and this Agreement on which to base 10b-5 liability.

Along with the requirement that a "security" exist, the second basic element of 10b-5 liability is that any alleged fraud must be "in connection with" the purchase or sale of any security. 15 U.S.C. § 78 j (b); 17 C.F.R. 240. 10b-5. The "in connection with" language means there must be a showing of causation between the alleged fraud and the plaintiff's purchase or sale of a security. *Ketchum v. Green,* 415 F. Supp. 1367 (W.D. Pa., 1976).

A case has been decided which is virtually identical to the facts in this case. In *Woodward v. Metro Bank of Dallas,* 522 F. 2d 84 (5th Cir., 1975), the court dismissed a 10b-5 action against the bank for lack of jurisdiction for failure to satisfy the "in connection with" language of the Act. an analysis of the facts in *Woodward* is important because it parallels the facts in the instant case so closely.

In *Woodward,* the president and controlling shareholder of a corporation which eventually went bankrupt requested the plaintiff to co-sign a note at the defendant bank. In return for this assistance, the corporation president promised to pay plaintiff $1,250.00 per month during the life of the note. The plaintiff co-signed the note, pledging her stock and a $50,000.00 C.D. as security. Later, plaintiff signed a renewal note at the same bank. The corporation defaulted, the bank liquidated the C.D. and began to foreclose on the stock. Plaintiff sued the bank, the bank loan officer and the corporation president under 10b-5.

As against the bank, plaintiff first argued that the note she co-signed was a "security". The court rejected this argument under the analysis set forth in Part A of this brief.

Secondly, plaintiff relied upon the agreement with the corporation president for $1,250.00 per month, alleging this was an investment contract. She alleged that the Bank failed to disclose to her the precarious financial position of the corporation, including frequent N.S.F. occurrences, that the corporation had other loans outstanding at the bank, that the loan proceeds would go to the president personally and not as working capital, that the bank benefited from the proceeds of the renewal note, that at the time of renewal the corporation had changed banks and that in co-signing the note, plaintiff was obligating herself to repay other outstanding loans at the bank of which she had no knowledge. These are very similar, albeit more sinister, charges to those in the instant case.

Since in *Woodward* the plaintiff did not loan money to the corporation but rather loaned credit and stock as collateral, the court had to analyze whether the bank was a proper party to the action. Like the "Agreement" attached to the Weaver complaint, the alleged investment contract was between plaintiff and the corporation president. It was not alleged, as it is not here, that the plaintiff invested in the bank or that the bank was investing in the company. Thus, to be liable at all, *the bank had to be vulnerable under the secondary liability theory of aiding and abetting.*

The court then analyzed the various elements necessary for liability as an aider and abettor. The elements under the test used in the Third Circuit are set forth in *Landy v. F.D.I.C.*, 486 F. 2d 139 (3rd Cir., 1973) and are: (1) the existence of an independent wrong; (2) *knowledge* on the part of the alleged aider and abettor of the wrong's existence, and (3) substantial assistance in effecting the wrong. 486 F. 2d 139 at 162-3.

The *Woodward* court concluded that the bank lacked the requisite knowledge to be held as an aider and abettor. The lack of disclosure by the bank was characterized as "sharp dealing, perhaps, but not a 10b-5 violation", mainly because the Texas Uniform Commercial Code contained no duty to disclose to an accommodation maker the financial condition of the primary obligor. 522 F. 2d 84 at 99. Thus the grant of the bank's motion to dismiss was affirmed.

An analysis of the facts in the present case lead to the same conclusion. Since the "Agreement" relied on the plaintiffs is clearly between the Piccirillos and the Weavers, the liability of Marine must be predicated upon the theory of aiding and abetting. Applying the Third Circuit test in *Landy v. F.D.I.C.*, the court must first find an independent wrong. If such a wrong exists, it exists in the relationship between Piccirillos and the Weavers. Secondly, and most importantly, the Bank must have *knowledge* of the wrong and substantially assist in its effect. In reading the depositions and affidavits in this case, it is uncontradicted that the Bank did not know of either the existence of or contents of the "Agreement" which is alleged to be the investment contract. The story surrounding the "Agreement" emerges as follows. The "Agreement" was suggested by Raymond Piccirillo, Jr. to Mr. Weaver. Piccirillo offered Weaver a "little share of the business". (Depo. E. Weaver, p. 24-5). The written agreement was prepared by Piccirillo's attorney. (Depo. E. Weaver, p. 31). The document was delivered by Piccirillo and his wife to the Weaver home, where the four of them negotiated certain changes and signed it. (Depo. E. Weaver, p. 51-52). Mr. Weaver kept a copy of the agreement. (Depo. E. Weaver, p. 52). To satisfy the test of *Landy v. F.D.I.C.*, the bank must have *knowledge* of the agreement. The record is clear that it did not. When asked if he ever told the bank of this "side" agreement, Weaver responded:

> "No; they never knew about that agreement, that I know of. I never told them. In fact, I never was to the bank from the time I loaned the money, put the money in the C.D. . . ." Depo. E. Weaver, p. 29).

Again:

> Q. - "Did you ever tell Mr. Dagget or Mr. Santom about that "Agreement?"
>
> E. Weaver - "No." (Depo. E. Weaver, p. 52).

Identical testimony was offered by Alice Weaver, his wife:

> Q. - "Did you tell Mr. Santom about the agreement with Mr. Piccirillo?"
>
> A. Weaver - "No."

Q. - "Is there any reason why you didn't tell him about it?"

A. Weaver - "No."

Q. - "You had the original of this in your possession, isn't that correct?"

A. Weaver - "That's right."

Q. - "But you didn't bring it with you to show it to the Marine Bank at all?"

A. Weaver - "No." (Depo. A. Weaver, p. 60-61).

Thus the test set forth in *Landy v. F.D.I.C.*, 486 F. 2d 139 at 162-3 has not been met.

The complaint alleges that the "deceptive and manipulative devises" used by Marine Bank consisted in the failure to disclose the financial details of Columbus Packing. Assuming for purposes of this motion that the Bank did not so inform the Weavers, this does not violate 10b-5. In the absence of a duty to disclose, the Bank's alleged silence cannot be construed to be aiding and abetting the purchase of a security of which it had no knowledge. In *Landy*, plaintiffs alleged certain brokerage firms failed to disclose to them a fraud perpetrated by the president of the company in which plaintiff's purchased securities. The court found that since the brokers did not know plaintiffs were purchasing shares at the time and, even if they did know, they were under no affirmative obligation to disclose, jurisdiction did not arise under 10b-5. Pennsylvania law dealing with commercial paper imposes no duty on banks to disclose to a guarantor the financial situation of the primary debtor. 12A P.S. 3-416, Pa. U.C.C. § 3-416. As noted in *Woodward*, no significance can be attached to the Bank's requirement of additional collateral, as the *raison d'etre* of a guarantor is to add financial support.

To hold the bank accountable to 10b-5 liability in this case would have the effect of making all banks the insurers of the conduct of their debtors, since any time the debtor was engaged in a fraud and the bank's loan assisted the fraud, the bank would be liable. This type of attempt to extend 10b-5 to encompass anyone who comes at all

in touch with the purchase or sale of security was squarely rejected as to banks in *Woodward* and as to brokers in *Landy*. Business activity is often governed by other laws, as noted in *Woodward*, such as the Uniform Commercial Code, Truth-in-Lending, antitrust and state fraud provisions. However, under these facts, the claim does not fall with the purview of 10b-5.

Respectfully submitted,

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APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and
ALICE WEAVER *Plaintiffs*

v.

Civil Action No. 79-66 Erie

MARINE BANK
Defendant

ORDER ON MOTION

AND NOW, January 31, 1980, the Clerk has called my attention to a motion to amend the complaint filed January 25, 1980. In Paragraph 2, counsel mentions the judgment in favor of the Marine Bank which was entered pursuant to Rule 56. In Paragraph 3, counsel mentions that affidavits and briefs filed by plaintiff in opposition to the motion for summary judgment set forth additional theories of liability, which were not set forth specifically in the complaint initiating this claim. But it is my view that under Rule 15, especilly 15(a) and (c), there is no necessity to amend the complaint, as counsel mentions Rule 56 was applied after reviewing all the pleadings, despositions, affidavits, and briefs filed by the respective parties. Thus, all theories of liability advanced by plaintiff have been considered and will be before the Court of Appeals. Therefore, under the situation presented in the motion, an amendment is unnecessary. The motion to amend is denied.

IT IS SO ORDERED.

JOSEPH P. WILLSON,
Senior District Judge

CC:
Andrew J. Conner, Esq.
Daniel L. R. Miller, Esq.,
and Christine H. McClure, Esq.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

Samuel Weaver and Alice Weaver,
Appellants

v.

Marine Bank

(D. C. Civil No. 79-0066)

On Appeal From The United States District Court
For The Western District Of Pennsylvania

Present: GIBBONS, WEIS and SLOVITER, Circuit Judges

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel on September 18, 1980.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed January 11, 1980, be, and the same is hereby reversed, and the cause is remanded for further proceedings consistent with the opinion of this Court. Costs taxed against appellee.

ATTEST:

Sally Mrvos
Clerk

December 15, 1980

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

SAMUEL WEAVER and ALICE WEAVER, *Appellants*

v.

MARINE BANK

(D.C. Civil No. 79-0066)

Before: GIBBONS, WEIS and SLOVITER, *Circuit Judges*

Upon the consideration of the petition for rehearing by petitioner before the original panel,

It is ORDERED that the petition for rehearing before the original panel is denied.

By the Court

JOHN J. GIBBONS
Circuit Judge

January 26, 1981